

2007

Instructions for Form N-66

(Rev. 2007)

Real Estate Mortgage Investment Conduit Income Tax Return

(Section references are to the Internal Revenue Code unless otherwise noted.)

General Instructions

Purpose of Form.—Form N-66 is used to report the income, deductions, and gains and losses from the operation of a real estate mortgage investment conduit (REMIC).

Where to Get Tax Forms.—Hawaii tax forms, instructions, and schedules may be obtained at any taxation district office or through the following:

Website:
www.hawaii.gov/tax

Forms By Fax/Mail:
808-587-7572
Toll-Free: 1-800-222-7572

Where to Get Tax Information.—Contact the Department of Taxation's Taxpayer Services Branch at:

Telephone: 808-587-4242
Toll-Free: 1-800-222-3229

For the hearing impaired:
808-587-1418

Toll-Free: 1-800-887-8974

Who Must File.—An entity that elects to be treated as a REMIC for its first tax year (and for which the election is still in effect) **and** that meets the requirements of section 860D(a) must file Form N-66.

A REMIC is any entity—

- (a) to which an election to be treated as a REMIC applies for the tax year and all prior tax years,
- (b) where all of the interests are regular interests or residual interests,
- (c) that has one (and only one) class of residual interests (and all distributions, if any, with respect to such interests are pro rata),
- (d) where as of the close of the 3rd month beginning after the startup day and at all times thereafter, substantially all of the assets consist of qualified mortgages and permitted investments,
- (e) that has a tax year that is a calendar year, and
- (f) with a startup day after March 31, 1988 (unless formed under a binding written contract in effect on that date), with respect to which there are reasonable arrangements designed to ensure that: (i) residual interests are not held by disqualified organizations (as defined in section 860E(e)(5)), and (ii) information necessary for the application of section 860E(e) will be made available by the entity.

See section 860G for definitions and special rules. See section 860D(a) for qualification as a REMIC during a qualified liquidation.

Making the Election.—The election to be treated as a REMIC is made by timely filing, for the first tax year of its existence, a Form N-66 signed by an authorized person. Once the election is made, it stays in effect for all years until it is terminated.

First Tax Year.—For the first year of a REMIC's existence, the REMIC must furnish in a separate statement attached to the REMIC's initial return the following:

- (1) information concerning the terms of the regular interests and the designated residual interest of the REMIC, or a copy of the offering circular or prospectus containing such information, and
- (2) a description of the prepayment and reinvestment assumptions made in accordance with section 1272(a)(6) and the regulations thereunder, including documentation supporting the selection of the prepayment assumption.

Termination of Election.—If any entity ceases to be a REMIC at any time during the tax year, the election to be a REMIC terminates for such year and all succeeding years. An entity is considered to cease being a REMIC when it no longer meets the requirements of section 860D(a). For the tax year the entity ceased to qualify as a REMIC and for all future years, you must file the tax form for similarly organized entities (corporations, partnerships, trusts, etc.).

When to File.—A REMIC must file Form N-66 by the 20th day of the 4th month following the close of its tax year.

However, if 2007 is the entity's final return, Form N-66 is due by the 20th day of the 4th month following the date the REMIC ceased to exist.

If you need more time to file a REMIC return, file Form N-100 by the regular due date of the REMIC return.

If, after you have filed Form N-100, you still need more time to file the REMIC return, file Form N-100A for additional extension of up to 3 months. To obtain this additional extension of time to file, you must show reasonable cause for the additional time you are requesting. Form N-100A must be filed by the extended due date of the REMIC return.

Federal Form 7004, Application for Automatic 6-Month Extension of Time to File Certain Business Income Tax, Information, and Other Returns, may not be used in lieu of Form N-100 and/or Form N-100A.

The official U.S. Post Office cancellation mark will be considered primary evidence of the date of filing of tax documents and payments.

Hawaii has adopted the Internal Revenue Code provision to allow documents and payments delivered by a designated private delivery service to qualify for the "timely mailing treated as timely filing/paying rule." The Department of Taxation will conform to the Internal Revenue Service listing of designated private delivery service and type of delivery services qualifying under this provision. Timely filing of mail which does not bear the U.S. Post Office cancellation mark or the date recorded or marked by the designated delivery service will be determined by reference to other competent evidence. The private delivery service can tell you how to get written proof of the mailing date.

Period Covered.—File the 2007 return for:

- 1. Calendar year 2007,
- 2. Short tax years beginning and ending in 2007, or
- 3. Short tax years beginning and ending in 2008, if the 2008 Form N-66 is not available by the time the REMIC is required to file its return. However, the REMIC must show its 2008 tax year on the 2007 Form N-66 and incorporate any tax law changes that are effective for tax years beginning after December 31, 2007.

Note: *In the case of 2 or 3 above, fill in the tax year space at the top of the form.*

Where to File.—File Form N-66 with the Hawaii Department of Taxation, P.O. Box 3559, Honolulu, Hawaii 96811-3559.

Accounting Method.—A REMIC must compute its taxable income (or net loss) using the accrual method of accounting. See section 860C(b).

Under the accrual method, an amount is includible in income when:

- All the events have occurred that fix the right to receive the income, which is the earliest of the date: (a) the required performance takes place, (b) payment is due, or (c) payment is received and
- The amount can be determined with reasonable accuracy.

See Regulations section 1.451-1(a) for details.

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year when:

- All events that determine the liability have occurred,
- The amount of the liability can be figured with reasonable accuracy, and
- Economic performance takes place with respect to the expense.

There are exceptions to the economic performance rule for certain items, including recurring expenses. See section 461(h) and the related regulations for the rules for determining when economic performance takes place.

Recordkeeping.—The REMIC records must be kept as long as their contents may be material in the administration of any Hawaii Income Tax Law. Copies of the filed tax returns should also be kept as part of the REMIC's records. See federal Pub. 583, Starting a Business and Keeping Records, for more information.

Final Return.—If the REMIC ceases to exist during the year, check the box at Item D(1), page 1, Form N-66.

The Item D(1) box of Schedule Q (Form N-66), Quarterly Notice to Residual Interest Holder of REMIC Taxable Income or Net Loss Allocation, should also be checked to indicate when the schedule is for the final quarter of the year.

Amended Return.—If after the REMIC files its return, it later becomes aware of any changes it must make to income, deductions, etc., the REMIC should file an amended:

- Form N-66 and check the box at Item D(4), page 1.
- Schedule Q (Form N-66), for each residual interest holder, and check the box at Item D(2). Give corrected Schedules Q (Form N-66) to each residual interest holder.

Note: If a REMIC does not meet the small REMIC exception under sections 860F(e), 6231, and the regulations thereunder, or if a REMIC makes the election described in section 6231(a)(1)(B)(ii), the amended return will be a request for administrative adjustment, and federal Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR), must be filed by the Tax Matters Person. See sections 860F(e) and 6227 for more information.

Information Returns That May Be Required

Form N-196, Annual Summary and Transmittal of Hawaii Information Returns. Use this form to summarize and send information returns to the Department of Taxation.

Federal Forms 1099-INT, MISC, OID, and R. You may have to file these information returns to report interest income, miscellaneous income, original issue discount and total distributions from profit-sharing plans, retirement plans, individual retirement arrangements, insurance contracts, etc. Also, use these returns to report amounts that were received as a nominee on behalf of another person.

Note: A REMIC must file federal Forms 1099-INT and 1099-OID, as appropriate, to report accrued income of \$10 or more of regular interest holders (including corporate regular interest holders). Also, every REMIC must file information returns if, in the course of its trade or business during the calendar year, it makes payments of rents, commissions, or other fixed or determinable income totaling \$600 or more to any one person.

Assembling the Return.—If you need more space on the forms or schedules, attach separate sheets. Use the same arrangement as the printed forms, and **show the totals on the printed forms.** Be sure to put the REMIC's name and federal employer identification number on each sheet. Also, each separate sheet should clearly indicate the line

or section on the printed form to which the information relates.

Please complete every applicable entry space on Form N-66. Do not attach statements and write "See Attached" in lieu of completing the entry space on this form.

Contributions to the REMIC.—Generally, no gain or loss is recognized by the REMIC or any of the regular or residual interest holders when property is transferred to the REMIC in exchange for an interest in the REMIC. The adjusted basis of the interest received equals the adjusted basis of the property transferred to the REMIC.

The basis to the REMIC of property transferred by a regular or residual interest holder is its fair market value immediately after its transfer. If the issue price of a regular interest exceeds its adjusted basis, the excess is included in income by the regular interest holder as accrued market discount for the tax years to which it is attributable under the rules of section 1278(b). If the issue price of a residual interest exceeds its adjusted basis, the excess is amortized and included in the residual interest holder's income ratably over the anticipated life of the REMIC.

If the adjusted basis of a regular interest exceeds its issue price, the regular interest holder treats the excess as amortizable bond premium subject to the rules of section 171. If the adjusted basis of a residual interest exceeds its issue price, the excess is deductible ratably over the life of the REMIC.

Signatures

REMIC with a startup day after November 9, 1988.—For a REMIC with a startup day after November 9, 1988, Form N-66 may be signed by any person who could sign the return of the entity in the absence of the REMIC election. Thus, the return of a REMIC which is a corporation or trust would be signed by a corporate officer or trustee, respectively. For REMICs which consist of segregated pools of assets, the returns would be signed by any person who could sign the return of the entity which owns assets of the REMIC under applicable State law.

REMIC with a startup day before November 10, 1988.—A REMIC with a startup day before November 10, 1988, may elect to apply the rules for REMICs with a startup day after November 9, 1988. Otherwise, Form N-66 must be signed by a residual interest holder or by a fiduciary who is acting for the REMIC and who has furnished adequate notice.

Note: For this purpose, the term "startup day" means any day selected by a REMIC that is on or before the first day on which interests in such REMIC are issued. Otherwise, "startup day" is defined in the instructions for Item B below.

The REMIC may authorize the Department of Taxation to discuss its tax return with its paid preparer by checking the "Yes" box above the paid preparer's signature. Checking "Yes" will allow the Department to contact the paid preparer to answer any questions that may arise during the processing of the REMIC's return.

Note: This designee does not replace the power of attorney form.

Paid Preparer's Information.—If someone prepares the return and does not charge the REMIC, that person should not sign the REMIC return.

Generally, anyone who is paid to prepare the REMIC return must sign the return and fill in the other blanks in the **Paid Preparer's Use Only** area

of the return. The preparer may furnish his or her alternative identifying number for income tax return preparers (PTIN) instead of his or her social security number.

The preparer required to sign the REMIC's return must complete the required preparer information and:

- Sign it, by hand, in the space provided for the preparer's signature. (Signature stamps or labels are not acceptable.)
- Give the REMIC a copy of the return in addition to the copy to be filed with the Department of Taxation.

Specific Instructions

Form N-66

Name, Address, and Federal Employer Identification Number.—Print or type the REMIC's legal name and address on the appropriate lines.

If the REMIC's address is outside the United States or its possessions or territories, enter the information on the line for "City or town, state, and ZIP code" in the following order: city, province or state, postal code, and the name of the country. **Do not** abbreviate the country name.

Note: Each REMIC must have its own federal employer identification number.

Enter the federal employer identification number (FEIN) in Item A on page 1 of Form N-66. If the REMIC does not have a FEIN, it must apply for one by filing federal Form SS-4, Application for Employer Identification Number. If the FEIN has not been received by the filing time for Form N-66, write "Applied For" in the space for the FEIN. See federal Pub. 583 for more information.

Item B. Date REMIC Started.—Enter the "startup day" selected by the REMIC as defined in section 860G(a)(9).

The startup day is the day on which the REMIC issued all of its regular and residual interests. However, a sponsor may contribute property to a REMIC in exchange for regular and residual interests over any period of 10 consecutive days and the REMIC may designate any one of those 10 days as the startup day. The day so designated is then the startup day, and all interests are treated as issued on that day.

Item C. Total Assets at End of Tax Year.—Enter the total assets of the REMIC. If there are no assets at the end of the tax year, enter the total assets as of the beginning of the tax year.

Item E. Hawaii Tax I.D. No.—Enter the REMIC's general excise Hawaii Tax I.D. No.

Section I

Income. (Lines 1-6).—Do not include on lines 1-6 any income that is tax-exempt or any income from prohibited transactions.

Line 1. Taxable Interest.—Enter the total taxable interest. "Taxable interest" is interest that is included in ordinary income from all sources except interest exempt from tax and interest on tax-free covenant bonds.

Line 2. Accrued Market Discount Under Section 860C(b)(1)(B).—Enter the amount of market discount attributable to the current tax year determined on the basis of a constant interest rate under the rules of section 1276(b)(2).

Line 3. Capital Gain (or Loss).—Enter the amount shown on line 12 or 13 (as applicable), Schedule D, page 2.

Line 4. Ordinary Gain (or Loss).—Enter the net gain (or loss) from line 19, Part II, Schedule D-1.

Line 5. Other Income.—Enter any other taxable income not listed above and explain its nature on an attached schedule. If the REMIC issued regular interests at a premium, the net amount of such premium is income that must be prorated over the term of such interests. Include such income on this line.

Deductions. (Lines 7-14).—Do not include any nondeductible amounts on lines 7-14. A REMIC is not allowed the following deductions in computing its taxable income:

1. The net operating loss deduction;
2. The deduction for taxes paid or accrued to foreign countries and U.S. possessions;
3. The deduction for charitable contributions;
4. The deduction for depletion under section 611 for oil and gas wells; and,
5. Losses or deductions allocable to prohibited transactions.

Line 9. Amount Accrued to Regular Interest Holders in the REMIC That is Deductible as Interest.—Regular interests in the REMIC are treated as indebtedness for federal income tax purposes. Enter the amount of interest, including original issue discount, paid or accrued to regular interest holders for the tax year. Do not deduct any amounts paid or accrued with respect to residual interests in the REMIC.

Line 10. Other Interest.—Do not include interest deducted on line 9 or interest on indebtedness incurred or continued to purchase or carry obligations on which the interest is wholly exempt from income tax.

Line 11. Taxes.—Enter taxes paid or accrued during the tax year, but do not include the following:

1. Federal income taxes (except the tax on net income from foreclosure property);
2. Foreign or U.S. possession income taxes;
3. Taxes not imposed on the REMIC; or
4. Taxes, including State or local sales taxes, that are paid or incurred in connection with an acquisition or disposition of property (such taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition).

Note: *If you have to pay tax on net income from foreclosure property, you should include this tax (from line 10 of federal Form 1066, Schedule J) here on line 11.*

See section 164(d) for apportionment of taxes on real property between the seller and purchaser.

Line 12. Depreciation from Federal Form 4562.—Complete and attach federal Form 4562.

Note: *Hawaii did not adopt the federal provisions for bonus depreciation and the increased IRC section 179 deduction.*

If a depreciation deduction is claimed for Hawaii tax purposes, the REMIC must: (a) complete a federal Form 4562 for Hawaii tax purposes, and (b) attach the completed federal Form 4562 to the Hawaii tax return. The REMIC must also keep records of the differences in the asset's depreciable basis for federal and Hawaii tax purposes.

Line 13. Other Deductions.—Enter any other allowable deductions for which no line is provided on Form N-66.

Schedule D

General Instructions

Purpose of Schedule.—For a REMIC with a startup day before November 12, 1991, use Schedule D to report the sale or exchange of capital assets. To report sales or exchanges of property other than capital assets, see Schedule D-1 and the related instructions.

A REMIC with a startup day after November 11, 1991, must use Schedule D-1 instead of Schedule D because all of its gains and losses from the sale or exchange of any property are treated as ordinary gains and losses.

For amounts received from an installment sale, the holding period rule in effect in the year of sale will determine the treatment of amounts received as long-term or short-term capital gain.

Report every sale or exchange of property in detail, even though there is no gain or loss.

For more information, see federal Pub. 544, Sales and Other Dispositions of Assets.

Capital Gain Distributions.—On line 7, report as long-term capital gain distributions: (a) capital gain distributions; and (b) the REMIC's share of the undistributed capital gain from a mutual fund or other regulated investment company.

For more information on mutual fund transactions, see federal Pub. 564, Mutual Fund Distributions.

Losses on Worthless Securities.—If any securities that are capital assets become worthless during the tax year, the loss is a loss from the sale or exchange of capital assets as of the last day of the tax year.

Losses From Wash Sales.—The REMIC cannot deduct losses from a wash sale of stock or securities. A wash sale occurs if the REMIC acquires (by purchase or exchange), or has a contract or option to acquire substantially identical stock or securities within 6 months before or after the date of the sale or exchange. See section 860F(d) for more information.

Installment Sales.—If the REMIC sold property (except publicly traded stock or securities) at a gain, and is to receive any payment in a tax year after the year of sale, it must use the installment method and federal Form 6252, Installment Sale Income, unless it elects not to use the installment method.

If the REMIC wants to elect out of the installment method, it must report the full amount of the gain on a timely filed return (including extensions).

Specific Instructions

Column (d). Sales Price.—Enter in this column either the gross sales price or the net sales price from the sale. On sales of stocks and bonds, report the gross amount as reported to the REMIC by the REMIC's broker on federal Form 1099-B, Proceeds From Broker and Barter Exchange Transactions, or similar statement. However, if the broker advised the REMIC that gross proceeds (gross sales price) less commissions and option premiums were reported to IRS, enter that net amount in column (d).

Column (e). Cost or Other Basis.—In general, the cost or other basis is the cost of the property plus purchase commissions and improvements, minus depreciation. If the REMIC got the property in a tax-free exchange, involuntary conversion, or wash sale of stock, it may not be able to use the ac-

tual cash cost as the basis. If the REMIC uses a basis other than cash cost, attach an explanation.

When selling stock, adjust the basis by subtracting all the nontaxable distributions received before the sale. This includes nontaxable dividends from utility company stock and mutual funds. Also adjust the basis for any stock splits.

Increase the cost or other basis by any expense of sale, such as broker's fee, commission, and option premium before making an entry in column (e), unless the REMIC reported net sales price in column (d).

For more information, see federal Pub. 551, Basis of Assets.

Designation of Tax Matters Person (TMP)

A REMIC may designate a tax matters person in the same manner in which a partnership may designate a tax matters partner under IRC Regulations section 301.6231(a)(7)-I. For purposes of applying that section, all holders of a residual interest in the REMIC are treated as general partners. The designation may be made by completing the Designation of Tax Matters Person section on page 3 of Form N-66.

Additional Information

Be sure to answer the questions and provide other information in items F through J. The instructions that follow are keyed to these items.

Item F. Type of Entity.—Check the box for the type of entity that the REMIC is recognized as under State law. If the REMIC is not a separate entity under State law, check the box for "Segregated Pool of Assets," and state the name and type of entity which owns the assets in the spaces provided.

Item G. Number of Residual Holders.—Enter the number of persons who were residual holders at any time during the tax year.

Item J. Sum of the Daily Accruals.—Enter the sum of the daily accruals for all residual interests for the calendar year. See section 860E(c)(2) for details.

Schedule L

Balance Sheets per Books

The amounts shown should agree with the REMIC's books and records. Attach a statement explaining any differences.

Line 1a. Cash flow investments are any investments of amounts received under qualified mortgages for a temporary period before distribution to holders of interests in the REMIC.

Line 1b. Qualified reserve assets include any intangible property which is held for investment and as part of a qualified reserve fund. For a definition of qualified reserve fund, including exceptions, see sections 860G(a)(7)(B) and (C).

Line 1c. Foreclosure property is any real property (including interests in real property), and any personal property incident to such real property, acquired by the REMIC as a result of the REMIC's having bid in such property at foreclosure, or having otherwise reduced such property to ownership or possession by agreement or process of law, after there was a default or imminent default on a qualified mortgage held by the REMIC. Generally, such property ceases to be foreclosure property at the close of the third tax year following the tax year

in which the REMIC acquired the property. See sections 860G(a)(8), 856(e), and IRC Regulations section 1.856-6 for additional information.

Note: *Solely for purposes of section 860D(a), the determination of whether any property is foreclosure property shall be made without regard to section 856(e)(4).*

Line 7. Regular interests are interests in the REMIC that are issued on the startup day with fixed terms and that are designated as regular interests, if:

- (1) such interest unconditionally entitles the holder to receive a specified principal amount or other similar amounts; and
- (2) interest payments (or other similar amounts), if any, with respect to such interest at or before maturity are payable based on a fixed rate (or to the extent provided in regulations, at a variable rate), or consist of a specified portion of the interest payments on qualified mortgages and such portion does not vary during the period such interest is outstanding.

The interest shall not fail to meet the requirements of subparagraph (1) merely because the timing (but not the amount) of the principal payments

(or other similar amounts) may be contingent on the extent of prepayments on qualified mortgages and the amount of income from permitted investments. An interest shall not fail to qualify as a regular interest solely because the specified principal amount of the regular interest (or the amount of interest accrued on the regular interest) can be reduced as a result of the nonoccurrence of 1 or more contingent payments with respect to any reverse mortgage loan held by the REMIC if, on the startup day for the REMIC, the sponsor reasonably believes that all principal and interest due under the regular interest will be paid at or prior to the liquidation of the REMIC.

Schedule M

Reconciliation of Residual Interest Holders' Capital Accounts

Show what caused the changes in the residual interest holders' capital accounts during the tax year.

The amounts shown should agree with the REMIC's books and records and the balance sheet amounts. Attach a statement explaining any differences.

Include in column (d) tax-exempt interest income, other tax-exempt income, income from prohibited transactions, income recorded on the REMIC's books but not included on this return, and allowable deductions not charged against book income this year.

Include in column (e) capital losses in excess of the \$3,000 limitation, other nondeductible amounts (such as losses from prohibited transactions and expenses connected with the production of tax-exempt income), deductions allocable to prohibited transactions, expenses recorded on books not deducted on this return, and taxable income not recorded on books this year.

Schedule Q

Quarterly Notice to Residual Interest Holder of REMIC Taxable Income or Net Loss Allocation

Attach a separate Copy A, Schedule Q (Form N-66), to Form N-66 for each person who was a residual interest holder at any time during the tax year and for each quarter in which such person was a residual holder.